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DIRECTORATE OF
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Intelligence Memorandum

The Yugoslav Economy: Off the Critical List?

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CONTENTS

CENTRAL INTELLIGENCE AGENCY
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INTELLIGENCE MEMORANDUM

THE YUGOSLAV ECONOMY: OFF THE CRITICAL LIST?

Introduction

1. After two years of uncontrolled inflation the Yugoslav economy has begun to show signs of improvement. Moreover, following a series of disruptions in 1971 – heated debates on economic policy, a major reduction of federal authority, and the Croat student strike – Tito finally stepped in to push for unified action toward economic stabilization but failed to achieve agreement on a concrete program. This memorandum analyzes recent economic trends, looks at the prospects for 1972, and discusses the longer range outlook for decentralized decisionmaking and economic stability.

Conclusions

2. Pressure on the Yugoslav economy has been eased now that a balance-of-payments crisis has been averted for the time being. Once again the United States and other Western nations are providing the necessary assistance by granting new hard currency credits and by rescheduling existing debt payments. However, the net effect of the assistance is to postpone the problem, not to solve it. Unless the Yugoslavs can restructure production to increase output of goods exportable to the West, the balance of payments will again be severely strained when the heavy repayments scheduled for the mid-1970s are resumed.

3. On the domestic front, the Yugoslavs are trying to wind up the current campaign against inflation by the end of 1972. Thus far, slowdowns in investment and industrial output have indicated that demand pressures

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

in the economy are lessening. Prices, however, continued to increase and prompted the government to impose a freeze on prices of all goods and services in late November 1971. Other measures for 1972 include moderate credit controls and steps designed to stem financial abuses by firms, banks, and government bodies.

4. These and other actions against this round of inflation have been taken far too slowly. Certainly the problem has been complex. Many enterprises have been short of operating capital so that strong credit restriction threatened widespread bankruptcy. The government has been well aware that too much control helped bring on the recession of 1966-67. Officials, however, have been indecisive as well as cautious. Earlier measures against inflation were thwarted or sidestepped by republics, enterprises, banks, and trade unions. Policymakers were too preoccupied by a major debate on the new constitutional reform and government reorganization to enforce stabilization policies strictly. Moreover, the latest measures were delayed by the Croat student strike in late November and early December 1971.

5. The strike was triggered by the longstanding complaint that the government reallocates much of Croatia's foreign exchange earnings in favor of the less developed republics. In doing so, the government not only has hampered Croatia's development but also has contributed to Yugoslav instability by allowing excessive and wasteful imports by inefficient firms in the South. The strike brought the debates and delays to a head. Tito stepped in, condemned the strikers, and forced the resignation of Croatia's top party leaders, who had been pushing – too vigorously – for greater decentralization. Tito also halted intra-party squabbling, thereby trying to force a consensus within the party on basic political and economic objectives and to prod the government into moving ahead with the stabilization program. What Tito has been able to achieve for 1972, however, remains uncertain.

6. In any case, this is not Yugoslavia's last bout with instability, nor is it the last time Tito – if he remains active – will have to intervene to get action. There are few, if any, policymakers who would opt permanently for the slower growth that could keep inflation and imports under control. The government – with its new 22-man presidium – will continue to find it hard to agree on the unpopular measures that will be needed periodically to combat instability. Even if the new federal government does develop a unified approach, implementation could be sabotaged by republics, which now have a greater role in forming and carrying out policy. Finally, without Tito the likelihood of disagreement should increase. With a future so likely to resemble the past, Yugoslavia's creditors in the West should expect periodic visits by the men from Belgrade to finance the Yugoslav experiment.

Discussion

From Stagnation to Inflation: 1967-70

7. The current economic crisis can be traced to the attempt to break the economy out of the recession of 1967. Fueled by a relaxation of credit controls in 1968, the economy in 1969-70 bolted into an inflationary boom.* This was hardly surprising. The money supply increased by 64% during 1968-70, and enterprises and banks quickly responded to the expansion. Investment spending rose 93% during 1968-70 (in current prices), pulling up prices of construction materials and leading to rapid increases in industrial output and in import requirements.

8. The expansion of 1968-70, however, began slowly. Industrial output, which had fallen slightly in 1967, grew by 5% in 1968 – certainly no strain on capacity. Outlays by industry on materials increased only 3% in 1968 as previously accumulated stocks were drawn upon. More revealing, imports of intermediate goods and raw materials – a bellwether of overheating in the economy – increased only 5% in 1968. (For data covering the boom of 1968-70, see Table 1.)

Table 1

Yugoslavia: Economic Indicators

1966 = 100

	1967	1968	1969	1970
Money supply	98	122	136	161
Investment (in current prices)	94	119	137	181
Outlays on materials (in current prices)	109	112	132	167
Nominal income of the employed	114	124	143	169
Cost of living	108	114	122	135
Industrial production	99	105	118	128
Imports	108	114	135	182
Exports	103	104	121	138

25X1

9. Excess capacity was eliminated in most sectors by 1969, and bottlenecks began to appear. The rate of industrial growth increased from 5% in 1968 to 12% in 1969 and then slipped to about 9% in 1970 as a result of supply imbalances and other production delays. Outlays on materials increased 18% in 1969 and 26% in 1970. Imports of intermediate and raw materials leaped ahead, growing by 26% in 1969 and by 41% in 1970.

10. Labor costs also grew substantially throughout the post-recession period in spite of sizable unemployment left over from 1967. Probably influenced by workers' councils, enterprises were slow to hire new workers, preferring to increase the wage-fund for the benefit of those already employed. Thus industrial employment rose only 7% during 1968-70, and total labor costs in industry increased 48% – 9% in 1968, 14% in 1969, and 18% in 1970. Initially, however, rising labor costs were not inflationary because productivity growth also was rapid; during 1968-70, real wages rose 18%, compared with a 21% gain in industrial output per man during that period.

11. Prices, which were relatively stable early in the recovery period, climbed higher as growth got out of control, as shown in the tabulation below:

	Annual Percentage Increase		
	1968	1969	1970
Industrial producers' prices	1.1	2.3	9.9
Retail prices	3.7	7.1	9.9

The rapid rise in prices actually understates inflationary pressure in the economy because price controls were maintained on one-third to one-half of marketed products during 1968-70. For example, producer prices of wood products – totally free of control – rose 44% during the period. Prices of construction materials – partly controlled – still rose by a substantial 23%.

12. Inflationary growth also had a severe impact on the balance of payments. Imports grew 68% during 1968-70, exactly twice as fast as exports. Sales abroad were dampened both by higher export prices and by the profitability of domestic sales. It was certainly much easier to sell at home than to scramble for larger foreign markets, particularly in the

West. Thus the trade deficit in 1970 climbed to a record $1.2 billion, of which $1.1 billion was with the hard currency area. In spite of large gains in tourism, workers' remittances, and other invisible earnings, the deficit in the balance of payments on current account reached a record $342 million in 1970.

13. The trade deficit continued to widen early in 1971; in May the Yugoslavs were finally forced to call for help. First to respond was the International Monetary Fund, which provided a $83.5 million stand-by credit in July. In the meantime, Yugoslavia initiated negotiations (most of which are not yet concluded) with major creditors, including the United States, the United Kingdom, West Germany, Italy, and Japan. The total hard currency assistance sought by the Yugoslavs was in the neighborhood of $500 million, but only about three-fourths of that amount has been received to date. (The terms and status of these requests for assistance are given in the Appendix.) The West was not the only source tapped. The Yugoslavs decided in June to use $90 million in unexpended Soviet credits and began negotiating for more; on 14 October the Yugoslavs indicated that negotiations had been successfully concluded, but the amount supplied is unknown. Finally, in January 1972, the USSR announced another credit of $130 million for the development of Yugoslavia's bauxite and alumina industries.

1971: Peak or Plateau?

14. The economic strains became more severe during most of 1971. By June the growth of industrial output was up to an annual rate of 12%, the cost of living was up by 15%, and the trade deficit was running 95% above that of the first half of 1970. (For quarterly data on 1971, see Table 2.) Moreover, inflation was complicated by growing illiquidity among enterprises. For many firms, profits were squeezed by rising labor and material costs, money holdings were tied up in securing investment loans, and new short-term credits from banks and from other firms were harder to obtain. During the first seven months of 1971, for example, the average period between sale and collection of receipts was 106 days, compared with 68 days in 1969. Many firms issued checks with insufficient cover: the number of organizations with accounts blocked for three or more months rose from 500 in January to 840 in July.

15. However, some hopeful signs began to appear by the third quarter. Although the trade deficit reached a new record of $1.4 billion in 1971, the third quarter deficit was 15% less and the fourth quarter deficit was 33% less than in the same periods of 1970. Imports in the fourth quarter fell at a 7% annual rate, and exports rose 13% (see Table 3). One reason for the improvement was a shift away from hard currency trade partners

Table 2

Yugoslavia: Selected Economic Indicators by Quarter, 1971

	Corresponding Quarter of 1970 = 100			
	January-March	April-June	July-September	October-December
Industrial production	111	112	110	109
Finished products (stocks)	98	103	107	111 a/
Employment in industry	104	105	105	105 a/
Construction-hours worked	98	102	100	103 a/
Value of new construction	119	129	128	110 a/
Investment in fixed assets	119	111	110	--
Retail trade	120	116	112	109 a/
Industrial producers' prices	114	114	116	116
Retail prices	112	114	116	117
Cost of living	113	116	116	117
Money supply	114	111	113	111 b/
Trade deficit	265	160	85	67 c/

a. October-November only.
b. October only.
c. Preliminary.

toward the clearing countries of CEMA. In the first nine months of 1971, hard currency imports accounted for 70% of the total compared with 75% in the first nine months of 1970. Hard currency exports also declined as a share, from 62% in the first nine months of 1970 to 58% in 1971. The hard currency deficit, however, began to look better in the third quarter – down 10% over the same period in 1970, compared with a 65% increase in the first half of 1971. Preliminary data on trade in the fourth quarter gave evidence that the Yugoslavs were able to contain historically booming, end-of-year imports and retain the gain they had made on the deficit. Hard currency imports accounted for almost 73% and exports about 54% of total fourth quarter trade. Although the hard currency deficit accounted for 114% of the total deficit for the fourth quarter, it was still 19% less than in the same period of 1970.

Table 3

Yugoslavia: Foreign Trade, by Quarter

Million US $

	Exports	Imports	Trade Balance
1970	1,679	2,874	-1,195
Jan-Mar	382	527	
Apr-Jun	415	710	
Jul-Sep	415	814	
Oct-Dec	467	823	
1971	1,816 a/	3,253 a/	-1,437
Jan-Mar	382	766	
Apr-Jun	409	881	
Jul-Sep	497	838	
Oct-Dec	528 a/	768 a/	

a. *Preliminary.*

16. The most dramatic evidence of the turnaround in the balance of payments is given by semi-annual data. In the first half of 1971 the current account deficit amounted to $406 million, while in the second half of the year the Yugoslavs had an $88 million surplus – a gain which reflects not only more balanced trade, but also improvement in invisible earnings, particularly in workers' remittances and in gross receipts from tourism. On the basis of results for the first ten months, the Yugoslavs were expecting net invisible receipts for 1971 to reach $1.1 billion, about 30% above those of 1970 (see Table 4). Thanks to these earnings, primarily in hard currency, the balance-of-payments deficit in 1971 was only about $318 million, of which about $290 million was in hard currency.

17. There also were favorable trends on the domestic front. The annual rate of increase in investment spending slid from 18% at the end of the first quarter to 11% at the end of the third quarter as compared to the 1970 total. In real terms, investment in January-September actually was less than during the same period in 1970. Reflecting the slowdown, construction activity began to fall off in the third quarter. Moreover, the growth of industrial production began declining in July, reaching an annual rate of 9% during the last quarter. This trend was reinforced by an 11% increase in industrial stocks of intermediate and finished goods during October-November.

Table 4

Yugoslavia: Balance-of-Payments on Current Account a/

Million US $

	1970	1971 b/
Balance on current account	*-342*	*-318*
Trade balance	-1,195	-1,437
Exports (f.o.b.)	1,679	1,816
Imports (c.i.f.)	-2,874	-3,253
Net invisibles	853	1,119
Tourism	175	175
Worker and emigrant remittances	500	715
Transportation	200	245
Net interest	-110	-115
Other invisibles	89	99

a. Because of rounding, components may not add to the totals shown.
b. Provisional; based on preliminary data, and on official and unofficial estimates.

18. Prices did not reflect the slowdown. A July dip in retail prices and in the cost-of-living index failed to produce a turnaround, and price rises resumed in August-December. For 1971 as a whole, industrial producers' prices rose by 15% and the cost-of-living by nearly 16%. The main force behind these increases was no longer investment demand nor, in view of rising stocks, supply bottlenecks. Instead, the demand-pull forces were taken over by cost-push factors – outlays on materials increased 32% through the third quarter of 1971, and nominal wages increased 21% during 1971.

19. The net result of these trends seems to be a leveling of the business cycle. This does not necessarily mean that a period of stability lies ahead. The economy could be heading for another downturn, or, as in 1970, when there was a pause in the rate of increase of output, it could be at another staging area for further inflationary growth. The outcome will depend upon Belgrade's ability to resolve problems in the timing, formation, and effectiveness of economic policy.

Policy Problems

20. Yugoslavia's policy record since 1968 has been as disturbing as the recurrence of inflation. As Premier Ribicic complained in an interview on 8 October 1970, "The state of affairs in the economy is that we ought to have done already yesterday what we are doing tomorrow... showing not only how far we have arrived, but also how late we are." Much the same thing could have been said at the end of 1971, when policymakers were putting together their fourth major stabilization program in a little over one year.

21. Between 1969 and October 1970, policymakers tried in vain to restrain the boom by using mild controls such as a 5% import surcharge and small changes in the bank reserve requirement and rediscount rate. Beginning at the end of October 1970 the government enacted emergency measures – a six-month freeze on industrial prices; fixed prices for wheat, sugar, fats, and rice; a 50% deposit on imports; a 20% deposit on consumer purchases; and a reduction in the limit on consumer credit from $800 to $480 per individual.

22. Also in October the government began drafting a second, broader stabilization program, which, when finally enacted in January-February 1971, included a 16.67% devaluation of the dinar, tighter restrictions on credits to enterprises, and limits to increases in government spending and wages. A third set of controls, enacted at the end of July 1971, focused on restricting consumption of imports and reducing bank credits to unprofitable enterprises. Import quotas were slashed, credits for imported automobiles eliminated, and credit tightened for firms producing goods with high import requirements. The availability of loans for enterprise investment and of short-term credits for working capital also was curtailed.

23. None of these measures had much impact. The price freeze was not enforced. The trade unions were able to water down wage controls to a meaningless 12% limit on the growth of "above-average" wages in 1971. Even this ceiling was not observed by republics, which were given the power to grant exceptions. Moreover, government bodies, particularly at the local and republic level, reportedly exceeded an 11% ceiling on the growth of budgetary spending by as much as 50% in the first half of 1971.

24. Much, but by no means all, of the failure of policy can be explained by the impending government reorganization. In the fall of 1970, Tito proposed that a collective presidency be established to take over some of his domestic duties and eventually to succeed him. The proposal triggered a major governmental and constitutional reform, much of which was concerned with transferring economic functions from the federal to

republican governments. Under these circumstances, and with an upcoming personnel shake-up in the Federal Executive Council, few officials felt much urgency about pushing the stabilization program. The January-February 1971 stabilization measures had sat in the Federal Assembly since November 1970 while the deputies debated the constitutional reform. Nationwide debates on the reform continued to erode policy enforcement until mid-summer 1971, when the new constitutional provisions finally were adopted.

25. Moreover, the government was trying to avoid the harsh reaction to inflation that helped bring on the recession of 1967. This time the situation was extremely complex. With substantial illiquidity among enterprises, strict controls on credits for working capital – imposed at the end of July 1971 – were immediately suspended for August because many firms could not meet even monthly payrolls. The economy, badly needing controls, was too sick to swallow its own medicine.

26. Policymakers were restrained by more than caution, however. They also were frustrated by internal dissension and footdragging at all levels of economic responsibility. Probably the most costly snag was an open Federal Executive Council debate on devaluation in the fall of 1970. Vice Premier Miljanic – in charge of the stabilization program and favoring an early devaluation – resigned when he was overruled by Premier Ribicic. Tito, apparently trying to cap the argument, curiously commented that "devaluation would come, but not now." The cat was out of the bag, and imports soared. By the time the government devalued in January, it was too late. Price increases had already destroyed the impact of devaluation; imports continued to rise, and exports even fell in the first half of 1971.

27. Later, in the fall of 1971, the reorganized federal government had its first encounter with the new constitutional powers of republics, with which major policy legislation must be coordinated, if possible, before passage. The fourth round of stabilization measures was proposed early in October. Designed to restore financial discipline, the measures provided for obligatory reserve funds in enterprises and government organs and for a new mechanism of administrative balancing of debits and credits to aid in settling outstanding debts of enterprises. At the same time the government unveiled the draft federal budget for 1972 and promised to have a proposal for the long-awaited reform of the foreign exchange system ready by early November.

28. Republican agreement on these measures was not obtained until late December. The Croats and Slovenes undoubtedly resented the added federal intervention implied by the reserve fund and debt management schemes; government control over the distribution of enterprise earnings

had been relaxed considerably since 1965. Nearly all republics found some fault with the planned federal budget. For one thing, it called for an increase in spending of about 6% over 1971, which was objectionable because federal financial functions were supposed to have been sharply trimmed in line with the constitutional reform. Moreover, federal revenues were reduced, leaving a large deficit to be financed by republics. Finally, by the end of November the government had not put forth its proposals on the foreign exchange system. This delay, combined with sub-surface complaints – probably aggravated by subversive Ustashi* elements – about federal policy in general, triggered the Croat student strike in Zagreb.

29. The students were echoing the longstanding complaint that the federal government reallocates too much of Croatia's large foreign exchange earnings to the have-not republics. This practice not only was inhibiting Croatia's imports of Western technology but also was contributing to general economic instability by allowing excessive imports by the less developed, less efficient regions. The Croatian party leaders – Savka Dabcevic-Kucar, Pero Pirker, and Miko Tripalo – were calling for a foreign exchange market in Yugoslavia, which was in line with their general demand for less federal influence in the economy. Many Croats wanted much more. Before the riots, a symposium of economists in Zagreb heard demands that the federation should not have any independent sources of income and that tax and tariff policy and even the right to issue money be given to the republics. One economist even remarked that the new constitution reduced "the possibility for a republic to pursue its own independent economic policy," a goal that is regional economic nationalism in a nutshell.

Tito Steps In

30. The Croatian party leadership's lax handling of the student strike infuriated Tito. He accused the republic party of being infested with "rotten liberalism" and in mid-December forced the resignation of Croatia's nationalist party leaders. He reasserted the need for federal supremacy over economic policy and called for tighter discipline within the federal party as well as among the republics on basic economic and political objectives. Tito also demanded progress in carrying out the stabilization program. To meet this goal, the second party conference was scheduled for late January. But by the time the conference opened, Tito was expressing alarm over the lack of direction and uncertainty on the part of many party officials. In contrast to his earlier warnings that Yugoslavia faced the worst crisis

* The Ustashi – one of the more violent, anti-Tito emigre groups – seek an independent Croatian state. Partly financed by the Soviets, the Ustashi engage in black propaganda and isolated acts of terrorism such as the assassination of the Yugoslav ambassador to Sweden in April 1971.

in the nation's post-war history, Tito led with a keynote address stressing unity and playing down the seriousness of the situation. In the final analysis, the conference agreed on little; the resolution on unity merely papered over differences. Tito nevertheless is in control of the situation. Moreover, should the party not regain the ground it lost during the Croatian crisis, Tito still has the loyalty of the military forces in the event of a future challenge to his authority. The armed forces again showed their devotion to Tito by strongly supporting his move against Croatian nationalists. As a result, the military has taken on a new political role in the decisionmaking process in Yugoslavia. The implications of this development for economic policy in 1972 are as yet uncertain.

31. Characteristically, Tito also gave the word to make changes in the foreign exchange system. In January 1972 the government announced that the amount of foreign exchange that can be retained by exporters would be raised from 7% to 20% in the case of most firms and from 40% to 45% for firms engaged in tourism – clearly a sop to the Croats. Belgrade also revealed plans to establish a market through the banking system to allocate most of the nonretained foreign exchange. The National Bank, however, will continue to supplement the foreign currency earnings of the backward areas.

32. Thus far, it is not clear what impact Tito's intervention has had on the stabilization program. Late in November the government had tried to buy more time by imposing another freeze on all prices and services. As a result of price adjustments and some probable exceptions, however, the cost of living rose by 1.3% in December – only slightly slower than the monthly rate during all of 1971. In December the government was able to push through new emergency controls on imports and acted swiftly in again devaluing the dinar (to 17 dinars per US $1 on 22 December) following the devaluation of the dollar. The Yugoslavs, taking advantage of the opportunity, devalued by 18.73%, relative to gold, whereas the US $1 was devalued by 7.89%.

Prospects for 1972

33. Encouraged by the trends in trade and output late in 1971, Yugoslav officials are predicting a return to economic stability in 1972. They hope that the cost of living will rise by only 5% and that imports can be held to only a 6% increase, compared with a 12%-14% rise in exports. These forecasts depend on achieving only small increases of 3%-4% in investment and in real personal incomes. Industrial output is expected to rise by about 8%.

34. According to the man in charge of the stabilization program – Vice Premier Jakov Sirotkivic – inflationary spending can be held in check

by a moderately restrictive credit policy. To prevent further price increases, however, the freeze has been extended to 1 April and will be maintained longer if necessary to keep prices from increasing by more than 5%. The missing link in policy so far is wage restriction. In late December, Sirotkovic stated that "there is no reason why personal income trends should be administratively regulated at the federal level." [redacted] Premier Dzemal Bijedic, in an interview on 31 December, indicated that temporary measures for "limiting the growth of individual categories of income," and also higher taxes on higher income groups, will be introduced by republics and provinces. This policy was again reaffirmed at the second party conference in January 1972.

25X1

35. Although the outlook generally is favorable for 1972, the economy is still at a crossroads. The extent of agreement on stabilization policy and the effect of Tito's recent moves are in doubt. Moreover, if a stabilization policy is actively pursued, even limited credit controls may cause investment to continue to slip, leading to further declines in the rate of industrial output. On the other hand, in view of the latest decentralization of economic authority, inflation could easily resume if republics do not prevent exceptions to price and income controls. Finally, pressure on the balance of payments soon may be renewed. The economic slowdown in Western Europe – particularly in West Germany and Italy, Yugoslavia's larger trade partners – will reduce demand for Yugoslav goods and services.

Beyond 1972

36. Yugoslavia will continue to be faced with periodic inflation and balance-of-payments problems. As Yugoslav policymakers are aware, the economy remains inherently unstable. Industrial output is heavily dependent on imports; enterprise management, under the influence of workers' councils, has a built-in bias toward excessive wage increases; and both banks and enterprises tend to overinvest because the interest rate is artifically fixed well below the expected rate of return on new investments. Even insolvency has not been so traumatic – firms in trouble normally can expect to be merged or otherwise rescued by local, republic, or federal governments. Finally, decentralization so far has undermined the impact of policy and has not led to hoped-for improvements in productivity and resource allocation.

37. Policymakers now have essentially three options. As in some Latin American countries, they can consistently press for rapid growth, surrendering to inflationary pressures by devaluing the dinar as necessary and resorting to direct import and price controls during bad export years. Such a policy would be popular with the public so long as wages were

not controlled, and it would favor the backward areas that have always gained during periods of rapid growth. The problem is that Yugoslavia's newer, faster growing sectors – chemicals, metal products, and other heavy manufacturing industries – will continue to generate few hard currency exports relative to their heavy reliance on imported machinery and materials. Thus, rapid growth would most likely result in a steady deterioration of the balance of payments, which could be stemmed only at the cost of worsening the terms of trade.

38. The other extreme would be to limit growth consistently and press for structural changes by rationing credits for investment, consumption, and imports and by limiting government spending and excessive wage increases. Such a policy might make investment in export and consumer industries more attractive and ultimately allow relaxation of direct controls on imports, prices, and the interest rate. Slower growth, however, would be hard to sell to the workers, who are accustomed to regular wage increases, or to the backward regions, where development would sag if an all-out campaign for efficiency were undertaken by the government.

39. The third alternative is a continuation of previous efforts to have both rapid growth and stability. As in the past, policy probably would involve ad hoc responses to inflation and recession. Nevertheless, this option seems most likely. The government desires a 7.5% average annual growth rate for national income during 1971-75, which implies a rapid 9%-10% rate of increase for industry. The last time such rates were sustained for more than two consecutive years was in the expansion of the last half of the 1950s. The outlook for the 1970s depends on substantial improvement in the government's ability to control the economy and in exports in order to finance rising imports. Unfortunately, the new constitutional reforms probably will forestall major gains in either of these areas.

40. The constitutional amendments further shifted important federal economic responsibilities to the republics and local governments. The federal budget is being cut back to cover only defense expenditures, the fund for the backward areas, and normal administrative expenses. Budget funds for "intervening in the economy" – such as many subsidies and export credits – are being eliminated. The extra-budgetary account for direct federal investment and other spending has been transferred to the republics. Aside from tariff and some tax receipts, most federal revenue now comes from contributions by the republics. This reduction in federal financial power would seem to all but eliminate the chances of introducing an effective fiscal policy.

41. The federal government continues to prepare the final version of the non-obligatory national plan and retains most of its current arsenal of

direct and indirect economic controls and emergency powers to restrain budget spending by other levels of government. Financial and economic policymaking, however, has been partly decentralized. National Banks are being set up in each of the republics and the two provinces. They not only will carry out federal monetary policy, but also will help form it – the governors of these banks make up the board of directors of the Yugoslav National Bank. Moreover, the new constitution includes a new requirement that the federal government formally seek approval from the republics on all major policy actions. Only after serious effort is made to coordinate policy can laws be passed over republican objections by the Federal Executive Council, the Federal Assembly, or the Presidium itself.

42. One consequence of increased regional responsibility is likely to be a continuation of inflationary investment policies. Production under these conditions will increase the quantities of goods that can be exported to Communist countries but not to the West. Simultaneously, rapid growth of industrial production will continue to stimulate imports from the West, especially semi-manufactures. The policy, in short, will promote hard currency deficits and clearing account surpluses.

43. Regional influences, however, could have a more serious impact. The record of economic policy since 1970 suggests that the economy must get completely out of hand before a stabilization policy can be put into effect. The new Presidium may well be a useful forum for airing and trying to compromise regional differences, but it is apt to talk too long when harsh, unpopular measures are needed to combat instability. Even if the new Presidium does develop a "Yugoslav" outlook, it will still have to reckon with the increased economic power of the republics, perhaps capable of thwarting even a strong federal hand in the economy.

44. Tito, of course, can intervene and speed the process of decisionmaking while he is still active – as he did last summer when he called a halt to the debate on the constitutional reforms, and in December when he forced the ouster of the Croatian party leaders and clamored for action on the stabilization program. Without Tito or at least without a consistent, agreed-upon set of policies, the economy probably will be periodically on the critical list. Under the most favorable assumptions about the political situation in Yugoslavia, the sharp cycles of the 1960s are likely to return in the 1970s, requiring another round of Western assistance to finance hard currency deficits.

APPENDIX

Current Status of Yugoslav Requests for Stabilization Assistance

The International Monetary Fund	In February 1971, the IMF approved a stand-by credit of $51.75 million, and by June the Yugoslavs had drawn approximately $30 million. However, in late May the Yugoslavs realized that, with their heavy repayment schedule, the remaining funds would be insufficient. The Yugoslavs then began negotiating with the IMF for a new credit. The February credit was canceled and on 29 July the IMF approved a new stand-by credit of $83.5 million. Approximately $52 million of the new stand-by credit remained on 31 December.
The United States	On 1 October the United States and the Yugoslavs exchanged Aides Memoire agreeing to reschedule $58.5 million in PL-480 and AID payments falling due in 1971-72. Terms include a two-year grace period and ten-year repayment period at 5% consolidated rate of interest. The United States also increased the Commodity Credit Corporation credit line by $20 million, and "encouraged" Export-Import Bank credits. Furthermore, the United States has provided diplomatic assistance to the Yugoslavs in their negotiations with other creditors.
Italy	In early October, Yugoslavia and Italy initialed an agreement dividing rescheduling into three $25 million portions for the period 1972-74. Repayment is to be made in seven and one-half years and includes one year of grace. The interest rate for the initial $25 million may be as high as 6.5%; the interest rate on the balance is to be determined by separate agreements.

West Germany	In late December the German government activated credits of approximately $93 million, of which $22 million was drawn by Yugoslavia. The remainder will be drawn in 1972 and 1973. Another $46 million also will be made available in 1973, but terms remain to be negotiated. Terms for the $93 million require lump sum payments to be made four years after drawing at a 6% rate of interest. However, the rate of interest applies only through 1974, rates for later periods remain to be discussed.
Japan	The Yugoslavs requested a hard currency credit of $30 million for 1971 and 1972 with terms including a two-year grace period and a 5.5% rate of interest. It is doubtful that the proposal will be accepted in this form by the Japanese. However, a debt rescheduling agreement might be forthcoming. In the meantime, the Japanese have offered a $10 million trade credit.
France	The French government has agreed in principle to grant approximately $20 million in hard currency credits. Although credits will apply only to the Yugoslavs' debt to the French, they will not be tied to new exports.
Belgium	The Yugoslavs requested $15 million in hard currency credit for 1972-73. Terms include a two-year grace period, a ten-year repayment period, and a 5% rate of interest. Prospects for agreement are reportedly favorable.
Sweden	In mid-November the Yugoslavs requested a total credit of $30 million to be disbursed in 1972, 1973, and 1974. Terms solicited include a two-year grace period, a ten-year repayment period, and a 5% rate of interest.

Other

The Yugoslavs requested $20 million from Canada, but never began any negotiation.

The United Kingdom was asked for $50 million, but responded that only export credits would be granted, a condition the Yugoslavs have found unacceptable.

Austria and the Netherlands have also been approached, but there is no further information at this time.

Finally, the Yugoslavs have sought consortium loans from private banks in both the United States and Switzerland. The response has been hesitant, but the Yugoslavs are still negotiating with the Swiss and may obtain up to $75 million in the United States.